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THE NFPA FORECAST: FEW ECONOMIC SURPRISES

There is almost no need to point out the obvious: the consistent growth of the U.S. economy has worked its way through the entire service sector of the economy but has left behind a number of basic manufacturing industries. Among those industries that have not shared in this economic success is the wood products industry, and especially the softwood lumber industry.

The Economy in General is Holding Its Own, But for How Long?

Many economic indicators have been remarkably constant during the past several months. During the third quarter, real growth in the Gross National Product measured a modest gain of 2.8 percent. The Federal Reserve discount rate has remained at 7.5 percent since May. In the housing market, starts have hovered at a rate around 1.7 to 1.8 million for the first nine months, while sales for the first six months were at a seasonally adjusted annual rate of 694,000--the highest rate since 1979. Unemployment has remained constant, and the economy has been creating new jobs at an average rate of 268,600 per month.

Consumer spending, responsible for the third quarter gains in the GNP, is keeping the economy afloat but probably cannot maintain such a high level for very long. As a corollary to high consumer expenditures, consumer credit to finance those expenditures is soaring, while the U.S. savings rate is at an historic low. Generally, these phenomena do not bode well for the next few quarters, although no dramatic downturns are in store. A persistent dark cloud on the economic horizon are unreasonably high real interest rates; the spread between inflation and nominal interest rates is in the range of six to eight points.

A particularly bright spot is inflation, but even that is not all silver lining. Inflation, now running at an annual rate below 4 percent, was originally kept in check by an aggressively conservative Federal Reserve policy, but has since been controlled by an overvalued dollar. Imports encouraged by an overvalued dollar create competition, which tempers price increases. The immense competition caused by imports has kept inflation at its lowest point in 18 years, and has resulted in disinflation in a number of basic commodity groups.

For wood products, the disinflation is causing sluggish performance. The Department of Commerce reported that the total value of wood product shipments in 1983 was $49.2 billion. NFPA estimates that this changed little in 1984 and, when statistics are compiled for 1985, will show a slight decrease. Adjusted for inflation, the value of the industry's product shipments are down by 27 percent when compared with 1979 (Figure 1). The value of softwood lumber shipments, in particular, will show a decline because volume is off 4.1 percent and average prices are down. Softwood lumber's poor performance has significant impact on the industry as a whole, because softwood lumber accounts for 16

MONTHLY STATISTICAL HIGHLIGHTS

New orders for softwood lumber were up 7.9 percent in August, while inventories dropped slightly (0.1 percent).

During the first nine months of 1985, softwood lumber consumption was up 1.4 percent over the same period last year; hardwood lumber consumption was up 9.9 percent.

Softwood log exports are running 13.8 percent ahead of last year; Exports of all other wood products are down.

Shipments of mobile homes through August were reported at 193,600 units, down 5.4 percent from last year.

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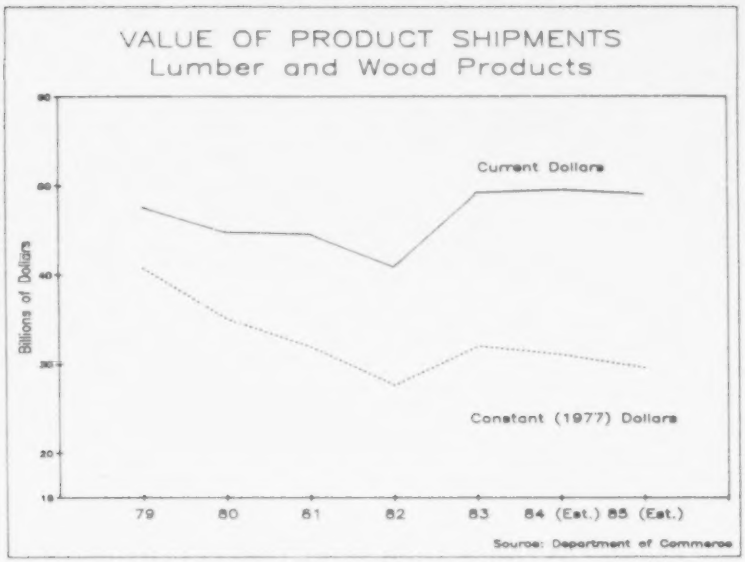
Figure 1: In real terms, the value of industry shipments is losing ground.



percent of industry shipments, the largest single product category.

Wood Products--Reaching Desperately for a Piece of the Action

A recap of the first 10 months of 1985 shows an industry still trying to grasp a piece of the economic recovery. Despite high production and consumption levels, earnings in wood products operations are sluggish at best. At worst, they have led to layoffs and mill closings. Trends bearing on the condition of the forest products industry include:

- Increases of softwood lumber imports from Canada, up approximately 14 percent; the Canadians now claim 33.4 percent of U.S. consumption, compared with 30.8 percent in 1984.

- Record consumption of softwood lumber and structural panels without any upward movement in average prices; the 1985 average Random Lengths Composite was $197 at the end of October, down from an average of $199 in 1984.

- Low corporate profits, compounded in the forest industries by lower performing paper operations; paper and paperboard production are down 1.7 and 3.8 percent, respectively.

- Cost-cutting by all producers; layoffs and mill closings by major companies.

- Small and medium-sized companies accounting for a greater share of total production.

Poor Economic Performance Forces Changes in the Industry

The 1982 recession and the ensuing period of depressed earnings has led to some major changes in the industry, evidenced by a number of events and circumstances during the past year. For example, among publicly traded forest products companies, there has been an increase in the number of greenmail attempts and successful mergers. With a diversity of assets (including large timberland holdings), and low stock prices attributable to poor earnings performance, forest products companies are attractive targets. Among the most publicized changes: St Regis merged into Champion International Corporation; control of Crown Zellerbach taken over by Sir James Goldsmith; and Pacific Lumber Company purchased by Maxxam Group, Inc. Potlatch Corporation also recently came under the gun of a prospective purchaser, and Santa Fe Industries announced that it would entertain offers for its Kirby Forest Products company.

Still other companies have taken internal actions to try to thwart any prospective takeover, or monetize assets. International Paper Company, for example, formed a limited partnership earlier this year to own and operate a portion of its timberland holdings. A large number of other individual mills of large and small companies have changed hands.

Major companies have taken moves to consolidate through divestiture or closing of operations. In a sense, large producers have taken on the role of the "marginal producer", a characterization once reserved for the small local sawmills in the industry. In 1983, the top 50 companies in the industry produced 63 percent of the total U.S. production. In 1984, that percentage was down to 54 percent. By the time the 1985 numbers are in, the top 50 producers may account for less than half percent of total U.S. production.

Several other factors will force further industry changes in the future. The effects of import competition is one such factor. As reported previously, imports have taken a stronghold in the U.S. wood products marketplace. Imports of softwood lumber from Canada now account for 33 percent of consumption and have been increasing yearly. The Canadian industry is heavily geared toward export to the U.S. and has been successfully capitalizing on every opportunity to increase market share. This is having a profound effect on the U.S. industry.

Recent developments in the public timber-dependent western U.S. are setting the stage for some additional problems. Because competition for federally owned timber is severe, and may worsen if the timber sale level declines, producers face an awesome dilemma. In some western regions, prices bid for national forest timber are creeping up once again, but product prices have taken a dive. The old saw "chasing low prices with more volume" applies. Producers are desperately trying to hold a position in the marketplace, but are being squeezed between high timber costs and low product prices.

On the Demand Side--Order Files are Healthy; Housing Strong

The outlook for housing reveals that cycles have now become less severe. Deregulation in the banking industry has produced more options for mortgage finance. Adjusted rate mortgages and other less conventional financing mechanisms provide flexibility to the home buyer to deal with changing interest rates. As a consequence, housing no longer is experiencing the wide yearly swings as was seen in the past.

The median price of new homes has escalated less in 1985 than in past years. Now at $82,400 (August), prices for new homes have tempered, and they have become, on average, bigger in size than they were just a few years ago. Having dipped to a low of 1,520 square feet in 1982, new homes in 1984 were constructed at an average floor size of 1,605 square feet.

During the past five months, the rate of permits issued for new housing has been higher than the rate of starts. This is the first time permits have exceeded starts over such a long period of time (Figure 2). Housing economists point to several possible reasons, but

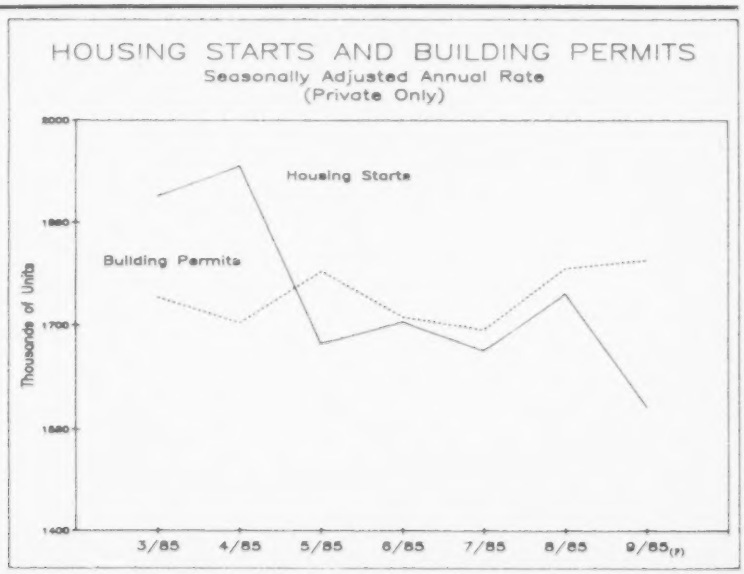


Figure 2: Housing permits have exceeded starts for five months running.

still remain somewhat perplexed. Deadlines imposed for major changes in building codes have been cited as a possible reason; apparently, changes in zoning and/or codes has stimulated issuance of permits in high housing start states such as New York and California. A high level of permits might simply be a statistical fluke, and therefore without much significance. On the other hand, the high rate of permits could mean housing starts will jump in the next few months, and during the first quarter of 1986. Even if this is the case, 1986 will see a moderation of starts overall.

The NFPA forecast looks for a decline in housing starts of seven to ten percent. The elevated use of consumer credit in 1985 may have "tapped out" the homebuyer and the pent-up demand created by the recession of 1982 has cleared. In addition, new household formations are expected to decline next year.

Non-residential construction will have experienced a record level in 1985, at an estimated $64.9 billion (1977 dollars), up 11 percent over last year. However, most economists believe high vacancy rates in office and hotel buildings in most areas of the country will lead to at least a moderate reduction of construction activity next year.

The Forecast in Brief

The three pending political/legislative issues affecting the economy are: deficit reduction, tax changes, and trade. Action on any one or more of these issues will influence the economy during 1986. Absent any legislative or administrative initiatives, the economy will continue to perform at a modest level, sluggish in a number of sectors including wood products. Next year will likely see slower growth, on the order of a 2 percent change in real GNP, and a moderation in housing starts down to the 1.65 million level. Wood products consumption should reflect this reduced level of housing demand.

Any improvement in company performance will come as a result of cost-cutting and consolidation. Imports will remain a major factor on price levels. The modest decline in the value of the dollar is not likely to significantly improve the export market.

THE NFPA FORECAST

Indicators

	1984	1985 (Est.)	1986 Forecast
Single-family Housing Starts (000)	1084.2	1121.0	1040.0
Multi-unit Housing Starts (000)	671.6	659.0	610.0
Mobile Home Shipments (000)	295.2	283.0	285.0
Other Construction (Billion 1977 $)	129.6	137.0	135.0
Industrial Prod. Index (1967 = 100)	163.3	165.2	166.0
Furniture & Fixtures Index (1967 = 100)	190.2	190.0	190

PRODUCTION AND TRADE

	Softwood Lumber (Bil BF)	Hardwood Lumber (Bil BF)[1]	Structural Panels (Bil SF)	Particleboard & MDF (Bil SF)
1984 U.S. CONSUMPTION	42.9	6.2	21.2	4.4
-imports	13.2	0.3	-	0.5
+exports	1.6	0.5	0.4	0.1
=SHIPMENTS	31.3	6.4	21.6	4.0
±inventory change	0.2	0.1	-	0.2
=PRODUCTION	31.1	6.3	21.6	3.8
1985 U.S. CONSUMPTION (Est.)	43.2	6.7	21.6	4.4
-imports	15.0	0.3	-	0.6
+exports	1.5	0.4	0.3	0.1
=SHIPMENTS	29.7	6.8	21.9	3.9
±inventory change	0.2	0.2	-	-
=PRODUCTION	29.5	6.6	21.9	3.9
1986 FORECAST				
U.S. CONSUMPTION	41.9	6.5	21.5	4.0
-imports	15.5	0.4	-	0.6
+exports	1.5	0.4	0.3	0.1
=SHIPMENTS	27.9	6.5	21.8	3.5
±inventory change	0.1	0.1	-	-
=PRODUCTION	27.8	6.6	21.8	3.5

[1]These data reflect revisions in NFPA's hardwood lumber data for 1984.

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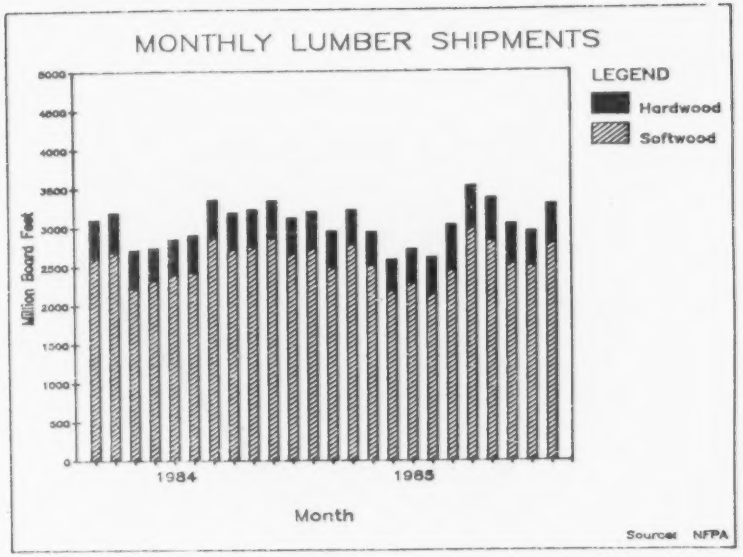
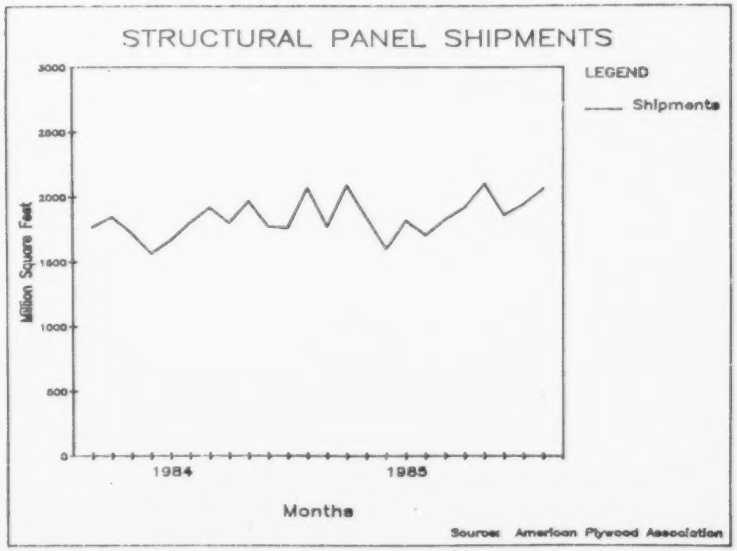
MONTHLY STATISTICS FOR THE WOOD PRODUCTS INDUSTRY

	ESTIMATED INDUSTRY TOTALS BY PRODUCING REGION				
	AUGUST 1985			AUGUST 31, 1985	
	Production	Shipments	Orders Received	Unfilled Orders	Gross Stocks
SOFTWOOD LUMBER		(Million Board Feet)			
Southern Pine Region	920	892	958	640	1,868
Douglas Fir Region	642	656	596	495	883
Western Pine Region	921	939	892	456	1,290
California Redwood Region	166	169	165	112	348
Other Softwoods	134	134	132	234	298
TOTAL SOFTWOODS	2,783	2,790	2,743	1,937	4,687
% Change - July 1985	8.8%	11.6%	7.9%	-2.4%	-0.1%
% Change - August 1984	4.5%	2.3%	7.7%	4.0%	-3.6%
HARDWOOD LUMBER					
Southern Hardwood Region	234	229	229	241	843
Appalachian Hardwood Reg.	35	34	34	*	*
Other Hardwoods	247	241	241	172	1,025
TOTAL HARDWOODS	516	504	504	413	1,868
% Change - July 1985	5.5%	13.3%	4.3%	0.0%	0.6%
% Change - August 1984	0.2%	6.3%	16.1%	11.0%	13.1%
TOTAL LUMBER	3,299	3,294	3,247	2,350	6,555
% Change - July 1985	8.3%	11.8%	7.3%	-2.0%	0.1%
% Change - August 1984	3.8%	2.9%	8.9%	5.1%	0.6%
* Included in Other Hardwoods					
FLOORING		(Thousand Feet)			
Oak Flooring (Bd. Ft.)	NA	11,104	NA	4,628	6,061
Maple Flooring (Sq. Ft.)	1,051	1,102	1,002	3,469	1,765
STRUCTURAL PANELS	2,037,698	2,053,785	1,906,367	370,045	363,261
% Change - July 1985	4.2%	6.1%	-2.2%	-29.8%	9.6%
% Change - August 1984	-1.5%	-0.3%	0.6%	-22.6%	20.3%





YEAR-TO-DATE PRODUCTION, SHIPMENTS, AND ORDERS

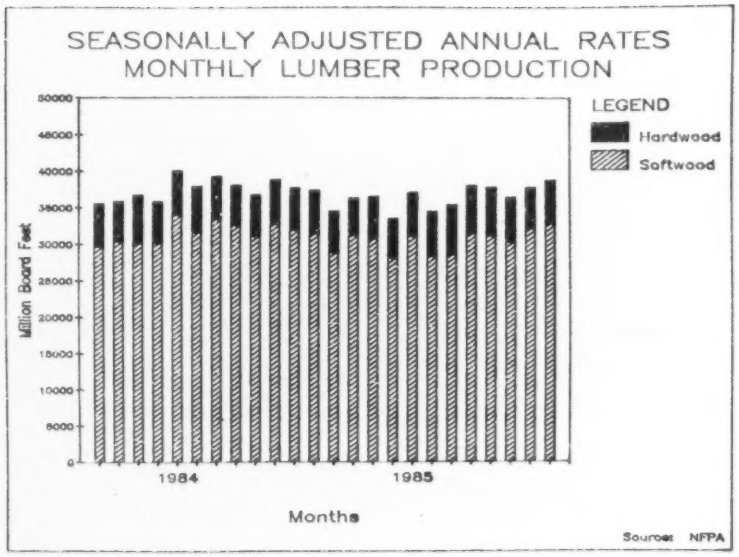
	PRODUCTION		SHIPMENTS		ORDERS RECEIVED	
	Latest Period Available	% Change	Latest Period Available	% Change	Latest Period Available	% Change
	8 mos. '85	8 mos. '84	8 mos. '85	8 mos. '84	8 mos. '85	8 mos. '84
	(Million Board Feet)					
TOTAL LUMBER	24,750	-3.2%	24,544	-2.6%	24,644	-0.3%
TOTAL SOFTWOOD	20,599	-4.9%	20,512	-4.1%	20,580	-1.9%
TOTAL HARDWOOD	4,151	6.1%	4,032	6.0%	4,064	8.6%

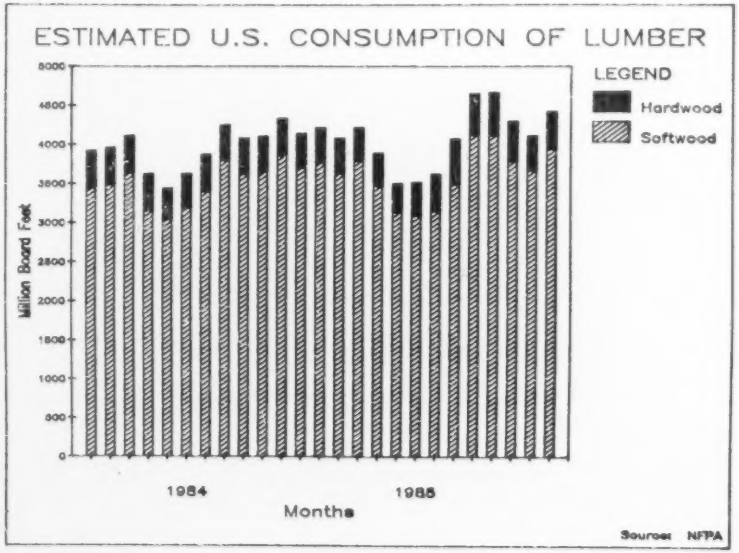
SEASONALLY ADJUSTED ANNUAL RATES

	PRODUCTION			SHIPMENTS		
		—% Change From—			—% Change From—	
LUMBER REGION	Aug. '85	July '85	Aug. '84	Aug. '85	July '85	Aug. '84
	(Million Board Feet)			(Million Board Feet)		
Southern Pine	10,920	-2.0%	-1.0%	10,567	-0.7%	-2.9%
Douglas Fir	7,346	-2.7%	-4.3%	7,673	6.5%	-11.4%
Western Pine	10,825	10.8%	16.9%	10,511	15.8%	18.1%
Calif. Redwood	1,928	2.0%	12.9%	1,930	6.8%	19.9%
Other Softwoods	1,546	2.1%	4.7%	1,537	4.6%	2.3%
TOTAL SOFTWOODS	32,765	2.1%	4.5%	32,217	6.7%	2.1%
TOTAL HARDWOODS	5,954	4.2%	0.2%	5,866	5.2%	6.3%
TOTAL LUMBER	38,718	2.5%	3.8%	38,083	6.4%	2.7%

U.S. LUMBER CONSUMPTION

	CURRENT			YEAR-TO-DATE	
	Latest Month Available	—% Change From—		Latest Period Available	% Change From
	Aug. '85	July '85	Aug. '84	8 mos. '85	8 mos. '84
	(Million Board Feet)				
Total Consumption	4,424	7.5%	5.0%	33,400	2.3%
Softwood Consumption	3,942	7.4%	4.7%	29,384	1.4%
Hardwood Consumption	482	8.3%	7.5%	4,016	9.9%





INTERNATIONAL TRADE STATISTICS

		VOLUME				VALUE (000$)			
		Aug. '85	8 mo. 1985	% Change From July'85	% Change From 8 mo. 1984	Aug. '85	8 mo. 1985	% Change From July'85	% Change From 8 mo. 1984
EXPORTS									
SOFTWOOD LUMBER	MMBF	130.8	1,007.8	11.6%	-8.0%	42,816	331,615	10.9%	-10.0%
To Canada	MMBF	28.6	201.5	7.5%	-20.0%	7,296	50,748	13.6%	-13.8%
SOFTWOOD LOGS	MMBF	321.8	2,503.4	-1.0%	13.8%	102,345	789,052	-2.7%	8.2%
SOFTWOOD PLYWOOD	MMSF 3/8"	12.6	200.3	-23.8%	-28.6%	3,748	47,729	-10.7%	-27.2%
HARDWOOD LUMBER	MMBF	35.9	264.0	27.3%	-18.6%	22,568	164,366	26.3%	-14.6%
HARDWOOD LOGS	MMBF	4.6	82.9	-60.3%	-39.6%	3,149	66,061	-55.9%	-14.0%
HARDWOOD VENEER	MMSFsurf	51.5	500.3	-22.7%	-29.9%	4,012	39,954	-21.3%	-31.1%
PARTICLEBOARD	MMSF 3/4"	10.2	71.3	35.1%	-6.5%	1,851	14,267	6.6%	-25.3%
ALL OTHER		NA	NA	NA	NA	45,317	318,380	21.1%	0.9%
TOTAL U.S. EXPORTS		NA	NA	NA	NA	231,109	1,785,441	5.0%	-3.1%
IMPORTS									
SOFTWOOD LUMBER	MMBF	1,282.5	9,879.6	-0.3%	13.7%	263,746	1,954,913	-2.5%	9.2%
From Canada	MMBF	1,278.4	9,831.5	-0.3%	13.5%	262,521	1,944,920	-2.4%	9.2%
SOFTWOOD LOGS	MMBF	2.9	38.8	304.3%	-51.7%	601	10,541	115.4%	8.5%
SOFTWOOD PLYWOOD	MMSF 3/8"	5.7	54.3	-2.9%	15.2%	1,152	13,294	-39.8%	27.4%
HARDWOOD LUMBER	MMBF	24.2	254.6	-15.2%	15.0%	11,793	126,403	-27.2%	7.3%
HARDWOOD LOGS	MMBF	6.0	18.0	86.2%	-3.3%	322	2,520	-22.2%	-14.7%
HARDWOOD VENEER	MMSFsurf	125.3	938.9	-15.5%	-14.8%	9,330	68,198	0.9%	-26.4%
HARDWOOD PLYWOOD	MMSF 3/8"	200.8	2,328.5	-31.3%	9.1%	24,077	293,008	-31.4%	-3.9%
HARDBOARD	MMSFsurf	60.4	479.1	-6.8%	155.1%	3,719	34,193	-9.1%	2.5%
PARTICLEBOARD	MMSF 3/4"	124,375.8	986,502.2	-0.7%	10.0%	11,972	88,725	5.1%	5.4%
ALL OTHER		NA	NA	NA	NA	90,992	678,764	-5.2%	0.3%
TOTAL U.S. IMPORTS		NA	NA	NA	NA	417,704	3,273,127	-6.3%	4.7%

Note: Volume total is not possible because the products are in different units of measure.